Tax Tips

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Shifting income, or income splitting is a compelling question for many higher tax bracket wage earners to consider. But beware, the Income Tax Act contains rules specifically designed to identify and eliminate anti-avoidance and attribution. This article attempts to clarify the rules and understand the restrictions.

Shifting income, or income splitting, from higher tax bracket wage earners has restrictions you need to understand!

❖ **Shifting income, or income splitting is subject to Income Tax Act rules:**

The *Income Tax Act* contains many rules that are designed to eliminate the ability for a taxpayer in a high tax bracket (typically paying 45-50% tax on each dollar of taxable income over about $128,000) to shift income to a lower-bracket taxpayer (who might be paying from 0%-30%).

The process of shifting income is called "income splitting". The rules to prevent income splitting include "Anti-avoidance" and "Attribution" rules.

✓ **Anti Avoidance**

Anti-avoidance rules are added to specific sections of the Act as perceived abuses are highlighted, and there is also a general anti-avoidance rule (GAAR) that tax planners must always consider.

✓**Attribution rules: Property Transfer**

These rules are not added or changed as frequently as anti-avoidance rules, but they are no less important.

Most attribution rules treat the income earned by the low-bracket taxpayer to be that of the high-bracket taxpayer who transferred or loaned the property. The most common attribution rules apply when a taxpayer transfers property (including money), directly or indirectly, to the taxpayer's spouse, or to a related child, niece or nephew who is under 18.

✓**Attribution: Capital Gains**

The attribution rules will generally deem all income earned on the property to be the transferor's income for tax purposes. Note that where property is transferred to minors, capital gains earned on the property are *not* attributed back to the transferor. Capital gains are attributed to spouses unless the property is transferred in a way that avoids the attribution rules.

It is generally well-known that both property income and capital gains will be attributed back if the transfer is between spouses, and that only the

income will be attributed if the transfer is to a minor.

✓Exceptions worth remembering:

•Business income (watch for Kiddie Tax) and "second generation" income (income on the income that was already attributed) are *not* attributed back to the original transferor.

• Example: if a parent buys a bond for a minor child, the interest on the bond will be treated as the parent's income. However, the interest earned on reinvestment of the bond interest will not be attributed and will be treated as the child's income.

While this may seem like an insignificant plan, when you factor in the current low interest rate environment, the age of the minor child and the amount that can be earned on the reinvested interest as rates increase, the plan can be simple and financially rewarding.

✓Family Trusts and Dividends:

This concept can be used in more complicated scenarios as well. For example, many operating companies are owned by a family trust with spouses and minor children as beneficiaries.

•When this type of corporation has excess cash it can pay a dividend to the trust. The business owner is likely in the same tax bracket as the trust (both high rates) so the tax on the dividend may be relatively comparable.

•If the dividend is earned by a trust, however, the income can be left in the trust to earn second-generation income that can be distributed to the spouse or minor beneficiaries who may pay a lower rate of tax.

In summary:

Even with anti-avoidance and attribution rules to contend with, taxpayers can continue to split income if the circumstances and financial benefit are favourable. However, no planning of this nature should be undertaken without professional advice.

The information presented is only of a general nature, may omit many details and special rules, is current only as of its published date, and accordingly cannot be regarded as legal or tax advice. Please contact our office for more information on this subject and how it pertains to your specific tax or financial situation.

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